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Tri-State Generation and Transmission Association Inc., Colorado; Rural Electric Coop

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Tri-State Generation and Transmission Association Inc., Colorado; Rural Electric Coop

Credit Profile

Tri-State Generation & Transmission Assn RURELCCOO

Long Term Rating

A/Stable

Outlook Revised

Colowyo Coal Funding Corp., Colorado

Tri-State Generation & Transmission Assn, Colorado

Colowyo Coal Funding Corp. (Tri-State Generation & Transmission Assn) 10.19% coal contract receivable collateralized bonds due 11/15/2016

Long Term Rating

A/Stable

Outlook Revised

Gallup, New Mexico

Tri-State Generation & Transmission Assn, Colorado

Gallup (Tri-state Generation & Transmission Assn) poll cntl rev rfdg bonds (Tri-State Gen & Transmission Inc. Proj) ser 2005 due 08/15/2017

Unenhanced Rating

A(SPUR)/Stable

Outlook Revised

Rationale

Standard & Poor's Ratings Services has revised its outlook to stable from negative and affirmed its 'A' rating on the following:

- The issuer credit rating (ICR) and senior secured debt on Tri-State Generation and Transmission Association Inc., Colo.;
- Gallup, N.M.'s debt issued on the utility's behalf;
- Colowyo Coal Funding Corp., Colo.'s bonds due Nov. 15, 2016, and guaranteed by Tri-State; and
- The cooperative's 2003 series A and series B pass-through trust certificates that financed the construction of the Springerville Unit 3 power plant through a lease structure (\$494.9 million outstanding as of Dec. 31, 2015).

The outlook revision reflects Tri-State's significant progress in resolving the regulatory proceedings in which member cooperatives challenged the utility's ratemaking authority. The revised outlook also reflects the utility's potential to achieve stronger annual debt service coverage (DSC) because of the reamortization of its debt through a 2014 refinancing. Tri-State produced 1.4x DSC and 1.3x fixed charge coverage (FCC) in 2015. We also consider the utility's projections of DSC of at least 1.4x and FCC of at least 1.3x through 2020 to be plausible. The 2015 and projected DSC and FCC represent a departure from the weak coverage from operating revenues of less than 1.0x during 2011-2012 and 1.1x in 2013-2014. During those years, the utility used funds it had deposited with the Rural Utilities Service (RUS) as a form of a rate-stabilization fund to supplement operating revenues and bolster financial performance. The utility needed to use reserves because member discord limited or precluded rate adjustments in those years. Tri-State used bond proceeds to fund its deposits at the RUS.

Our FCC calculation treats capacity payments to other generation suppliers as debt service in lieu of operating expenses because we view these payments as a vehicle for funding the suppliers' recovery of capital investments in

generation. Standard & Poor's treats fixed payments under purchase power agreements and Tri-State's tolling contracts as debt service rather than operating expenses because we consider these payments as funding the other generation owners' investments in plant. Because of consolidation since 2009, lease payments relating to the Springerville coal plant are now recorded as debt service in the financial statements, and Standard & Poor's treats them as such.

The utility's 2014 refinancing transactions replaced RUS debt with capital market debt, extended portions of existing debt balances and, thereby reduced debt service for about 10 years. Transactions in 2010 and 2014 transactions also deferred about 30% of principal to later years through the use of bullet maturities that postpone \$250 million of principal repayment to 2024, \$500 million to 2040, and \$250 million to 2044. Total debt at Dec. 31, 2015 was nearly \$3.4 billion.

Although the amount of the restructuring's annual debt service savings will decline each year, the utility nevertheless projects relatively stable DSC and FCC while introducing modest rate increases. Tri-State expects that lower debt service will reduce rate pressures on its member distribution cooperatives, allow for greater use of cash financing of portions of its large capital program, and appease members that have challenged recent years' rate adjustments.

Tri-State is a generation and transmission cooperative serving 44 members across a 200,000-square-mile area in portions of Wyoming, Nebraska, Colorado, and New Mexico. It indirectly serves about 626,000 retail customers. Its members have exclusive rights to sell retail electricity in their defined service territories. Energy sales data show that Tri-State's end-use customers' electricity consumption places it among the 10 largest generation and transmission cooperatives in the U.S. Leading customers' concentration in the natural gas and petroleum sectors temper some of the benefits of the breadth of the customer base.

Sales to non-members represented 16%-23% of total energy sales during 2009-2013 and about 15% of operating revenues. However, a high level of contracted nonmember sales tempers risks of revenue-stream volatility. Also, the percentage of members' contributions to energy sales has been increasing, rising to 84% in 2015 from 80% in 2013, 74% in 2007 and 75% in 2008. We view the trend of rising member sales as reducing the utility's exposure to wholesale markets and their uncertainties.

The cooperative's mortgage indenture provides that its revenues and most of its tangible assets secure its first mortgage bonds. The Springerville plant's Unit 3 and its related assets secure another approximately \$495 million of debt.

The 'A' ratings reflect our views of the following credit strengths:

- The utility projects what we consider to be sound DSC of at least 1.4x and FCC of at least 1.3x through 2020, based on the benefits of reamortizing debt and implementing moderate rate increases.
- Tri-State's financial forecast assumes that its nearly \$3.4 billion debt balance as of Dec. 31, 2015, will rise an average of \$100 million per year through 2020 to reach \$3.8 billion. These projections of \$500 million of additional debt compare favorably with the \$1.4 billion of capital spending it forecasts during those years.
- The utility projects that its 2014 debt reamortization and the near-term annual debt service reductions will leave a greater percentage of operating cash flow available for capital spending.
- Long-term, all-requirements wholesale power supply contracts with members contribute to the stability and

predictability of the revenue stream and extend through 2050, except for two that expire in 2040.

- Tri-State members' large customer base contributes to revenue-stream diversity. However, residential customers' modest 30% share of energy sales, sparse customer density, low service-area income levels, and customer concentrations in the natural gas and petroleum sectors, temper these benefits.

Standard & Poor's ratings also consider these exposures in its analysis:

- Tri-State sources nearly two-thirds of its energy from owned and contracted coal resources. We believe this high reliance exposes the utility and its customers to the costs of complying with emissions regulations such as the Environmental Protection Agency's Clean Power Plan.
- Although Tri-State has made significant strides in extinguishing several members' challenges to its ratemaking authority in Colorado, Nebraska, and New Mexico, settlement discussions in New Mexico are ongoing and could influence the utility's ratemaking authority in that state. Furthermore, the cooperative has yet to establish a track record demonstrating that extinguishing the regulatory challenges to its rates is capable of fostering member cohesiveness that restores ratemaking and financial flexibility.
- Tri-State's debt structure includes large bullet maturities in 2024, 2040, and 2044, without sinking funds. Although these structures skew DSC ratios relative to those of cooperative utilities that exclusively use amortizing debt, our analysis considered imputing a mortgage-style amortization for comparability and that analysis suggested that coverage would remain sound under that scenario.
- The use of significant bullet maturities defers to later years a sizable portion of the utility's financial burden.

Tri-State's nearly \$3.4 billion of debt at year-end 2015 was sharply higher than 2008's \$1.7 billion, in part because of 2009's consolidation of debt associated with the utility's lease interest in the Springerville Unit 3 coal generating station in Arizona. More recently, debt rose from \$3 billion at Dec. 31, 2012 to \$3.4 billion at Dec. 31, 2015.

Although the utility projects about \$1.4 billion of 2016-2020 capital spending, its financial forecast plausibly shows it adding a lesser \$500 million of debt because it expects that because its 2014 refinancing transaction reduced near-term debt service, it will have greater cash flow available for funding of capital spending, which will temper debt issuance. Investments in transmission and existing coal facilities represent the largest elements of the capital plan.

Six owned and leased, coal-fired, base load generation stations providing 1,874 megawatts (MW) of capacity dominate Tri-State's 2,841 MW power supply portfolio. Other key generation resources include 967 MW from natural gas- or oil-fueled peaking power plants, low-cost hydroelectric power purchases from the Western Area Power Administration (WAPA), and renewable resources consisting principally of wind turbines. Members' 2015 peak demand was 2,753 MW and peak demand has been between 2,600 MW and 2,800 MW during 2010-2015. Tri-State produces almost two-thirds of the electricity it sells.

The utility added the 416 MW of Springerville-leased coal capacity in 2006 and about 220 MW of gas-fired capacity under tolling contracts in 2009. In 2011, Tri-State purchased the Fort Lupton, Colo., 272 MW gas-fired, combined cycle power plant from Starwood Energy Group. The utility had leased 150 MWs of the plant under a tolling agreement before purchasing it. Although it purchased the combined cycle facility subject to an obligation to sell a portion of the plant's output to another party under a purchase power agreement that runs through 2019, the cooperative nevertheless expects the transaction to provide it with sufficient generation capacity through 2022.

The utility did not change rates in 2010 and 2011, and raised them 3.9% in 2012 and 4.9% in 2013. Challenges by New

Mexico members blocked rate adjustments in that state. Average wholesale rates of 7.1 cents per kilowatt-hour were unchanged for all members during 2013-2015 partially because of member discord, with Colorado and Nebraska members challenging the utility's rate adjustments and the cooperative's allocation of demand and energy charges. Because the utility has revised its rate structure's demand and energy charges and has made strides in resolving the customer conflicts, it predicts it has appeased customers and can incrementally raise rates up to 10% by the end of 2018. Tri-State lacks a formal fuel and purchased power adjustment mechanism. Consequently, its board's willingness to adjust rates as costs rise is an important credit quality indicator. Projections of moderate rate adjustments support plausible financial projections.

Outlook

The stable outlook reflects our view that 2014's debt reamortization is producing annual debt service savings that are bolstering coverage, benefiting bondholder protection, and creating capacity to fund about two-thirds of 2016-2020 capital needs with operating cash flow. In addition, progress in resolving customers' challenges to the utility's autonomous ratemaking authority could create capacity to adjust rates to achieve the sound coverage the cooperative projects.

Upside scenario

We do not expect to raise the rating within our two-year outlook horizon because Tri-State has yet to establish a track record of sound financial performance. In addition we consider the local economy to be exposed to the volatile oil and gas sectors. Furthermore, the cooperative, like many other utilities that depend heavily on coal for generation, needs to develop a strategy for responding to the Clean Power Plan that will preserve financial metrics.

Downside scenario

We could lower the rating if Tri-State does not achieve sound coverage in line with its projections whether due to member discord, a lack of ratemaking flexibility, higher-than-expected costs attributable to the capital plan or complying with environmental regulations.

Colowyo Coal Funding Corp. Debt

In 2011, Western Fuels Colorado, which is wholly owned by Tri-State, purchased the Colowyo Mine from Rio Tinto America Inc. The utility sources coal from the mine to fuel its Craig plant under supply contracts expiring in 2017. The purchase included Tri-State's agreement to guarantee about \$35 million of Colowyo debt, which ties our rating on Colowyo debt to our Tri-State ICR. The remaining \$7.7 million of Colowyo Bonds mature in November 2016. The utility has set aside funds to economically defease all the Colowyo debt. We consider the defeasance economic rather than legal. The collateral is mainly Treasury bonds, with a portion maturing shortly before each debt payment date. If for some reason, the collateral is insufficient to pay the bonds in full, Tri-State has an obligation to cover any shortfall. We consider the remaining guarantee's contingent exposure to be nominal relative to the cooperative's \$3.4 billion of debt. The Colowyo bonds cannot be accelerated.

Tri-State acquired the mine with unused bond proceeds. The utility has not disclosed the purchase price; however, we

believe it was favorable. The mine might need considerable investments to extend its life beyond the 2017 expiration of the existing supply contracts. Tri-State has not quantified the amount of the investments.

Springerville Generating Station Unit 3 Debt

In 2003, Tri-State financed the construction and acquisition of the Springerville Generating Station Unit 3 by creating a lease structure with Springerville Unit 3 Holding LLC, as the owner-lessor. The lessor issued notes to fund construction. In turn, a pass-through trust purchased the notes with the proceeds of the Tri-State 2003 series A and B pass-through trust certificates that the utility sold to investors. Although Tri-State's obligation to make lease payments is a general unsecured obligation of the utility, Unit 3 and its related assets at the plant site secure the certificates. As of Dec. 31, 2015, \$495 million of certificates were outstanding. Their maturities extend through 2033.

The lessor owns the power plant, and it leases the underlying land from Tucson Electric Power, Co. and has sublet it to Tri-State. The power plant lease is a triple net lease that is absolute, unconditional and not subject to abatement. The three-month outage to repair turbine damage in 2012 highlights the significance of these lease provisions.

Based on its 51% equity interest in the Springerville Unit 3 Partnership L.P., Tri-State fully consolidates the project's assets, liabilities, and expenses in its consolidated financial statements, and its income statement does not include lease expense.

Related Criteria And Research

Related Criteria

- USPF Criteria: Applying Key Rating Factors To U.S. Cooperative Utilities, Nov. 21, 2007
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of April 28, 2016)

Tri-State Generation & Transmission Assn unsecd revolv credit		
Long Term Rating	A/Stable	Outlook Revised
Tri-State Generation & Transmission Assn ICR		
Long Term Rating	A/Stable	Outlook Revised
Tri-State Generation & Transmission Assn RURELCCOO		
Long Term Rating	A/Stable	Outlook Revised
Many issues are enhanced by bond insurance.		

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